IN THE CIRCUIT COURT OF
THE 11TH JUDICIAL CIRCUIT
IN AND FOR DADE COUNTY, FLORIDA
GENERAL JURISDICTION DIVISION
CASE NO. 94-08273 CA (22)

HOWARD A. ENGLE, M.D.,
et al.,
Plaintiffs,
vs.
R.J. REYNOLDS TOBACCO
COMPANY, et al.,
Defendants.
_____/

Miami-Dade County Courthouse
Miami, Florida
Wednesday, 9:45 a.m.
June 7, 2000
PHASE II-B
TRIAL - VOLUME 536

The above-styled cause came on for trial before the Honorable Robert Paul Kaye, Circuit Judge, pursuant to notice.

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BRADLEY LERMAN, ESQ.
On behalf of Defendant Philip Morris
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On behalf of Defendant Philip Morris
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GORDON SMITH, ESQ.
On behalf of Defendant Brown & Williamson
CLARKE SILVERGLATE WILLIAMS & MONTGOMERY
KELLY ANNE LUTHER, ESQ.
On behalf of Defendants Liggett Group
and Brooke Group

APPEARANCES (Continued)
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On behalf of Defendant Council for Tobacco Research

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None			

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(Whereupon, the following proceedings were had:)
(Defendants' Exhibit 38600 and 38604 was marked for identification.)
THE COURT: Okay. Have a seat, folks.
Do I understand we have some matters to discuss before --
MR. WEBB: Just one brief matter that deals with scheduling.

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THE COURT: With or without the witness?
MR. WEBB: He can stay. We don't need to go to sidebar. I talked to Mr. Rosenblatt about this. The question is, when do we start the defense case?
THE COURT: That's a good question.
MR. WEBB: Let me tell you what Mr. Rosenblatt and I discussed, and see if Your Honor is in agreement. It appears when we finish Professor Mundstock, we have another witness, Dr. Blum. He's expected to take a couple, three hours. We don't know exactly how long. His testimony is limited. Mr. Rosenblatt said it might take that long.
We then have five deposition designations for five CEOs with a lot of objections and counterdesignations which require the normal line-by-line procedure that Your Honor has unfortunately suffered through with us before in the

case. But it's time consuming. That does take some time.
THE COURT: I think what you're saying is you probably won't start until Monday.
MR. WEBB: That's what we think.
THE COURT: I have no problem with that. If we try to get this out of the way on Thursday, that's fine with me. I don't care.
MR. WEBB: We wanted to confirm that. That's fine.
THE COURT: That's fine. I anticipated that.
MR. WEBB: Thank you. That's all.
THE COURT: Are you ready?
MR. ROSENBLATT: Yes.
THE COURT: You're ready, whoever is going to go next?
MR. MARKS: Yes.
THE COURT: Let's get the jury out, please.
It's a shame we can't utilize that Friday which would be a good time to get all the stuff out of the way on Thursday, but counsel can't make it by then.
MR. ROSENBLATT: I expect to rest by the end of the day Thursday.
THE COURT: I was trying to use Thursday to take care of the depos, the CEO depos.

MS. LUTHER: I don't think it's going to take that long, Judge.
MR. WEBB: We can do that maybe late this afternoon. I don't know.
THE COURT: What I need probably is the depos to review, or copies thereof.
MR. ROSENBLATT: We'll get those to you.
THE BAILIFF: Please rise for the jury.
(The jurors entered the courtroom.)
THE COURT: All right. Have a seat, folks. How is everybody this morning?
THE JURY PANEL: Fine.
THE COURT: Okay. We're rolling down the home stretch, believe it or not.
Has anything occurred over the evening that we ought to be aware of by way of whether you folks have received any information outside the courtroom or made up your minds about anything?
THE JURY PANEL: No, sir.

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THE COURT: Okay. We have one or two more cross examination presentations, and another redirect.

And then my understanding is, so you all know where we are in the way of things, there's one more witness on behalf of the plaintiff, and then we'll be into the next stage. After that, we'll be getting into

the defense case. So we're moving along.

Yes, sir.

MR. MARKS: Good morning, ladies and gentlemen.

THE JURY PANEL: Good morning.

CROSS EXAMINATION
OF GEORGE MUNDSTOCK

BY MR. MARKS:

Q. Good morning, Professor. I believe we met at your deposition about a month ago. To remind you, my name is Aaron Marks and I represent Liggett and Brooke Holding in this phase of the trial.

Yesterday you provided the jury with a valuation for Liggett of $1.8 billion.

A. Yes.

Q. However, when you were deposed a month ago, what you had calculated and testified to as an absolute, upper-bound sale valuation for Liggett, under the methodology that you preferred --

A. Yes.

Q. -- the maximum sale value for Liggett that you told us under oath was about half of that $1.8 billion; isn't that right?

A. Under my preferred; not the only, not -- probably the best methodology, the .9.

Q. Under the best methodology it was about $900 million?

A. Yes.

Q. And, Professor, in your deposition, again, only a month ago, you told us this $900 million, this maximum value that you calculated for Liggett, under the best method, that among all of the valuations that you had done for each of these five companies, your calculation for Liggett was the one that you were the least comfortable with; isn't that right?

A. Yes.

Q. Meaning that your maximum valuation of Liggett at $900 million, that valuation you believed relatively you may have overestimated by the most; is that correct?

A. I could have. The thing is that after the transaction where you sold off three of your four major brands to Philip Morris, your business had changed sufficiently that it was hard to extrapolate based on essentially a reformation of your business, if you will, from old Liggett to new Liggett.

Therefore, since old Liggett had four premium brands, and now you only have one premium brand, I was very nervous taking any historical information, because of the transformation of your business by your selling

three of your four premium brands to Philip Morris.

That was the -- and also because of your degree of leverage. Those were the two things that made me the most nervous.

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Q. You were uncomfortable with how high $900 million was, correct?
A. I was uncomfortable with it, period. Yeah.
Q. So I assume, Professor, you have zero confidence that Liggett could get its hands on $1.8 billion?
A. No. We don't have enough history of your operations after the sale of the brands. It's just -- you know, they do beta analysis, you get the spread; that the variance of your future outcomes I think is just much wider because of this radical transformation of your business in the recent past.
Q. So you --
A. But it could be -- of the two, obviously, I think that the .9 is closer to the center of the curve. But you could do much better.
Just as yesterday Mr. Gordon suggested, as the discount brands get closer in prices to the premium brands, I don't believe that to be the case, but he made -- asked me to assume that, then maybe the fact that you're mostly discount and wholesale will give you

advantage as the value of premium brands declines.
I don't believe that to be the case. In that scenario, you could do well. I don't know. The bottom line is it's hard to figure out for a company that's changed as radically as yours what the future is going to look like.
Q. So you feel you have a lack of information to get to something like $1.8 billion?
A. Yeah, lack of information -- there's a much higher, higher degree of certainty with your numbers than I believe at least with the other numbers.
Q. Professor, I want to talk to you about some things that may or should give you pause about valuating Liggett at such high numbers.
A. Sure.
Q. Now, for starters, in coming up with your maximum value figure for Liggett, you did indeed review and rely upon the financial statements of Liggett Group, Inc.; is that right?
A. Yeah.
Q. You saw that appended to Brooke Group's 1999 annual report and filed with the SEC there were financial statements for Liggett Group that were audited by Price Waterhouse Coopers, correct?
A. Freestanding for Liggett?

Q. Sure.
A. Appended to the SEC filing?
Q. Sure.
A. Yeah -- actually, I don't remember that, to be honest, because I got this. I don't deny it; I just -- I used their -- is this part of the -- that's --
Q. This was in -- what was appended to the SEC filing, correct?
A. Again, I don't remember, and I didn't bring your whole filing with me, but that is certainly word for word this document.
And it's stamped: "As filed with the SEC 33200," and Exhibit 99.2 -- I assume it's Liggett Exhibit 99.2 --

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Q. Professor, my only point is that Liggett's financial statements, you had them; they're audited by Price Waterhouse Coopers, correct, the same large auditing firm that Philip Morris uses, correct?
A. Yes.
Q. So you had these statements, you looked at them, you relied upon them in doing your calculations, correct, for Liggett?
A. For Liggett they were the sole basis, yes.
Q. Okay. Now, in reviewing these statements,

you didn't see anywhere on these statements that Liggett has cash or cash equivalents on hand or current assets that approach 900 million or $1.8 billion, did you?
A. No, I did not.
Q. In fact, you looked at Liggett's balance sheet -- I'm not very good with this, but I'm trying.
You saw that at the end of December 31st -- at the end of the year, December 31st, 1999, Liggett had cash and cash equivalents on hand that's less than -- not billion, but that's less than $3 million; is that right?
A. Yes.
Q. And total current assets which would include accounts receivable, inventories, that was only about $81 million?
A. Yeah.
Q. Is that right?
A. Again, in an industry that generates the kind of cash flow that this -- that may be low cash for some industries, say -- investing in real estate can be quite frightening; that low numbers of current cash in a business like tobacco, where they generate huge cash flows are less telling indicators of a company liquidity.

I mean, as you know, tobacco is one of the industries known for its ability to just generate cash, cash, cash.
Q. But you're not doubting the accuracy of this statement?
A. Oh, absolutely not.
Q. Okay. Thank you.
On the other side of the ledger, you saw current liabilities of $49 million, correct?
A. Give me a second.
Q. I believe it's the next page.
A. Yes.
Q. And we saw the stockholders' equity, which you agreed yesterday was equal to total assets minus total liabilities, and under generally accepted accounting principles, something called book value, net worth, of a little bit under $34 million; isn't that right?
A. Yeah. Again, they use the more -- the correct -- other companies it was shareholders' equity; here it's stockholders' equity.
Q. Again, you have no reason to doubt that Liggett's stockholders' equity at the end of 1999 was shy of $34 million; is that correct?
A. No, I do not.

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Q. Now, Professor, as I understand your testimony correctly, despite the fact that Liggett's stockholders' equity, according to generally accepted accounting principles, is somewhere around $34 million at the end of 1999, it is nevertheless your opinion that there is some sort of transaction or transactions that can be performed whereby Liggett's assets could be used to raise $900 million, $1.8 billion, for paying a punitive damage verdict in this case?

A. As I discussed what is now two days ago -- it seems like yesterday -- that everyone knows these are balances in accounts; these aren't values.

Your ability to raise money today is based on your value. Your ability to raise money over time is based on your ability to get your hands on cash.

Q. Okay.

A. These numbers are based on the history. Eve does not appear on these numbers. I don't know what the value of Eve is; probably not that great because you don't have that many brands.

But nowhere on these numbers, because you expense -- you treat it as money thrown out the door: All your advertising building up the Eve name, all the customer relations associated. You also, if I remember correctly, have one big customer. The relationship

with that customer does not appear here. It's been filled; it's been nourished over the years. None of that value appears on those numbers.

Q. Professor, I assure you, we'll get to that.

What you had said was the higher numbers based on Liggett's ability to get cash, right? Your number is based on their ability to get cash. And through a transaction --

A. Right.

Q. -- presumably what you said yesterday, a dead offering, something to that effect?

A. Accessing the equity markets -- the capital markets.

Q. Accessing the capital markets.

Now -- correct me if I'm wrong -- yesterday, when the lawyer for Philip Morris, Mr. Lerman, was questioning you, you stated that you don't know, you're not privy to information as to whether any of these companies have had any problems recently in accessing the capital markets; is that correct?

A. Well --

Q. That's not what you said?

A. My understanding from the public records is they've not even thought about accessing the equity markets.

Whether they've had trouble getting a bank loan, I don't know.

Q. Okay. Professor, I want to talk to you about what sort of access Liggett may have to the capital markets, because that's what your valuation is really about, right?

A. Yes.

Q. Now, from looking at the company's financial statements that you were provided, you already know that one of Liggett's parent companies already has a significant amount of debts on its books?

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A. Oh, yeah.
Q. That's correct, right?
A. Oh, yes.
Q. In fact, it was something called senior secured notes outstanding --
A. Right.
Q. -- that are payable by the company in time in about six months, January 31st, 2001?
A. I'm sorry. Which company?
Q. It's by one of Liggett's parent companies. I think it's called BGLS. Did you see that? Brooke --
A. I know you renamed your companies. I would have to check the chart. I know you have a great deal of debt.

Q. You have no reason to disbelieve what I just told you?
A. No.
Q. And the principal amount of that is somewhere around $80 million?
A. 80 million.
Q. 80 million. Not $800 million?
A. Not Philip Morris numbers.
Q. Not Philip Morris numbers. 80 million. And not even your numbers, right? 80 million is not 900 million. It's not $1.8 billion. It's 80 million?
A. Right.
Q. Do you know what the term "senior secured notes" means?
A. Presumably that they are the most secured against nonsenior, but perhaps better secured than even more senior.
Q. When notes are secured -- correct me if I'm wrong --
A. Not secured. Their order of priority on distribution. They may not actually be secured. Let me back up.
Some of these companies -- one that comes to mind is RJR. They don't just borrow money; they borrow money in layers. Because lenders, particularly in the

public capital markets, have different degrees of risk.
Some people, like myself, are very conservative and just put their money in the bank or in really good -- or invest by taking back notes from very conservative corporations because we don't want risk. We're willing to not have big interest rates in exchange for not taking risk. I'm risk adverse.
Why did I become a tax lawyer. Good question.
Q. My question --
A. Let me just finish this answer.
Q. Do you want me to sit down?
A. Yes, but putting that aside --
What happens is they -- the companies borrow in layers, so that their most risky debt plays a higher interest rate; next less risky debt pays a lower interest rate. Therefore, they come in layers like a cake, where the most senior is -- has the first right to the assets and pays the lowest interest rate.
As you get less senior, they pay a higher interest rate, but it's riskier. It has to stand in line after the other debt.

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Q. What you just said, the most senior pays the lowest interest rate --
A. That is correct.

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Q. And a secured note means that it's collateralized?
A. Well, it means that under the law, the lenders not only can go against -- fight with other lenders for the assets of the company, but they've got specific legal interest and specific properties that enables them to get the assets before anybody else, so they're the most safe.
Q. So they have first priority on those assets?
A. Yes.
Q. Before tort claimants?
A. In general.
Q. Now, the senior secured notes, BGLS-senior secured notes, whatever you want to call them, they are collateralized by Liggett's parent company's interest in Liggett?
A. Right.
Q. They are secured by the stock in Liggett; isn't that correct?
A. I don't know that for a fact. That's a common structure.
Q. So these secured noteholders --
A. Uh-huh.
Q. -- according to you --
A. Yeah.

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Q. -- would have first priority on the stock, the assets of Liggett?
A. If they are the only people with a security interest --
Q. Assuming that's correct.
A. Yes.
Q. So, Professor, just the existence of these senior secured notes, that have a priority position as to Liggett's assets, just their existence alone likely would have a negative impact on Liggett's ability to raise further capital for the purposes of paying --
A. So you're piercing the veil the other way now?
Q. I'm not suggesting any sort of piercing the veil. If Liggett's assets --
A. You told me I couldn't look at the corporate structure for valuing companies. Now you're looking at the corporate structure for valuing companies the other way.
Q. This is a very simple question.
THE COURT: Listen to the question. He raised the question. You give him the answer.
BY MR. MARKS:
Q. I'm just looking at Liggett.
A. Yes.

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Q. The fact that Liggett's assets, that someone already has a senior priority --
A. Are the assets pledged or the stock pledged?
Q. The stock is pledged.
A. Right, so the assets are not pledged.
Q. That's correct. I'm going to move on.
Professor -- actually, I'm going to stick

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with the notes for a second.
Professor, do you know what the interest rate is that Liggett's parent pays on those notes?
A. No.
Q. It's in the 10-K. 15.75 percent interest?
A. That's the stated rate.
Q. What is the difference?
A. Yield is what the economic effect is. I did not check the yield.
Q. Do you think that Liggett pays less than 15.75 percent? Do you have any reason to believe they pay less?
A. I have no reason to believe.
Q. That's a remarkably high interest rate, isn't it?
A. In the current economic climate.
Q. What is the prime rate today?
A. It's like 7 something.

Q. So they're paying more than double of prime; is that right?
A. I actually brought a chart of prime rates. Let me be accurate. And my chart of prime rates -- hold on. Is backwards. That's brilliant. Wrong chart.
In any event, it's around 8 percent.
Q. Professor, the --
A. In fact, it's higher than that.
Q. Professor, the fact that there is a 15.75 percent interest rate that accompanies those notes, that reflects that's a risky investment, isn't it?
A. Absolutely.
Q. Now, Professor, let me ask you this: You just told me the prime rate, 7, 8 percent --
A. I think it's more than that, actually. But go ahead.
Q. These notes bear 15.75 percent.
Professor, if Liggett's parent could have, in recent times, either negotiated a lower interest rate with its noteholders or negotiated some new deal in the capital markets to replace these 15.75 percent notes, don't you think they would?
A. Well, again, the key point, as we suggested earlier, is there is a difference between pledge of

stock and pledge of underlying assets. I don't know what their covenants --
Q. That's not my question.
MR. ROSENBLATT: Let him finish.
Q. This is a simple, obvious question.
A. Okay.
Q. If Liggett's parent didn't have to pay 15.75 percent interest --
A. Parent, correct?
Q. Right.
-- they wouldn't do that.
A. If they didn't have to do it without doing something they feel would interfere with their business, that's more burdensome, yes.
Q. Now, Professor, you are not aware of any source of capital for Liggett or its affiliates, or the cost of capital where the interest rate that the company would have to pay is less than 15.75 percent

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today, do you?
A. No.
Q. I'm correct, am I not, that you have not done any analysis or study, surveying the investment community, the capital markets, to determine what further funds, what further cash Liggett or its affiliates could access through issuance of bonds or

notes, taking on other debt, to fund the transactions that you contemplate this company would have to undertake to raise the sort of funds that you're talking about?
A. I'm sorry, I -- lost -- I have not --
Q. You have not -- I will shorten it up.
You haven't done any study, you haven't done any analysis, you haven't done any survey of the investment community, the capital markets, to figure out whether Liggett can fund the sort of transaction that you're talking about?
A. That is correct.
Q. Professor, do you know what the current credit rating is of Liggett or its affiliates?
A. I don't have it in front of me, no.
Q. You're aware, however, that firms like Moody's --
A. Right.
Q. -- Standard and Poors, what these companies do is that they rate companies' creditworthiness, right, and they have a grading system by which they attempt to grade riskiness, corporate bonds, notes, investment --
A. Can I ask a question? I've been looking. The prime rate as of May 17th was 9.5.

Q. A lot lower than 15.75?
A. A lot lower than 15.75, yeah.
Q. You're aware of Moody's and Standard and Poor's?
A. Yes, right.
Q. And you know what they do?
A. Yes.
Q. They give credit ratings?
A. Among other things, right.
Q. Now, a company like General Electric may have a rating from Moody's of --
A. Triple A.
Q. -- Triple A, probably, right?
General Electric is on solid grounds?
A. Coca-Cola is Triple A.
Q. Presents very low risk, right?
A company like RJR Tobacco Holdings may be something like Triple B-minus for Moody's because they are fairly more risky --
A. I don't know if it's that low, but it's certainly below Philip Morris.
Q. Just assume for the moment that RJR Tobacco Holdings is Triple B-minus. That's a more risky investment in the capital markets than General Electric or Coca-Cola?

A. Right.
Q. Professor, are you aware what grade Liggett's parent company's rate from Standard and Poors or

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Moody's --
A. Again, I rated Liggett, not the parent company. I'm sure they're quite low.
Q. Have you heard of a categorization called "noninvestment grade securities"?
A. Junk bonds.
Q. Junk bonds, things like junk bonds?
A. Right.
Q. Things that bear 15.75 percent interest rates?
A. Again, things that -- it would be inappropriate for a pension fund or an institutional investor to hold.
Q. Things that are so risky or things so creditunworthy that Moody's and Standard and Poors don't even give them ratings, correct?
A. Well, I mean, except for the fact that by saying it's so bad they're giving it --
Q. They're giving it a failing grade, right? They're saying it's so risky, and pension funds --
A. Pension funds shouldn't buy it.
Q. Now, pension funds, institutions, they're --

they are a substantial part of what you refer to when you refer to the capital market, aren't they?
A. Of the institutional capital market, yes.
Q. Institutional capital market, that's a large part. People sitting back here don't make up the size of -- part of the capital market that institutions make up, all right? CALPERS, the pension fund for the state of California --
A. TIAA-CREF, my pension.
Q. Now, committees for the financial institutions like the California pension fund, they have these investment committees, and they don't let -- as a general matter, they don't let these large entities, these large institutions, invest in noninvestment grade securities; is that right?
A. Yes.
Q. As a general matter.
So many of the institutions that participate and provide funds in this capital market that you've been talking about likely wouldn't even touch some sort of new dead offering, whatever the transaction is that you think that Liggett would be able to do in the capital markets; isn't that right?
A whole area, a whole segment of the capital market by their own rules --

A. Yes.
Q. -- would not touch this; is that right?
A. I think -- I mean, the context I would put it in is what was brought up by Mr. Lerman, I believe, yesterday, when we talked about securitization. I mean, the history of securitization was the banks didn't have enough capital to carry all the home loans; the pension plans were not willing to take them; and the banks were running out of capital.
So they securitized them in order to get X to take them out of the sort -- in that case, banking type credit markets and sell them to a broader market through a creative financial structure to change the face of finance in the '80s.

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So the fact that it is indeed troubling that institutional investors don't have enough capital, as was the case with home loans in the '80s, that there are ways of moving through transactions out of one piece of the capital market into another piece of the capital market.

Q. Professor, some of these terms you use, securitization and whatnot, doing things like that -- we talked a little about this yesterday -- it's expensive for a company; transactional costs for these sort of things are expensive.

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A. The thing -- I think I said this at deposition -- is with your company, for a company as -- you know, pick your number, a billion, half billion, whatever --

Q. There's what you did, pick your number, right?

A. No, it's not. I was trying to concede to you that the transaction costs get relatively more onerous as you get smaller; and that, therefore, the reason, as you asked me I think yesterday or the day before, that I was most troubled about Liggett is, because of its relative size.

Transaction costs for some of these deals, some of the transaction costs are based on a percentage, but some are absolute. And an absolute number is a bigger percentage of a smaller number. That was my reasons for being concerned about Liggett.

Q. Professor, it may be the case that -- because you have to have lawyers, investment bankers, underwriters, salespeople to try and go out and sell these risky securities. The fact is that the transaction costs for your sort of deal for Liggett may be prohibitive for doing this. It may eat up a large portion of what it is that you would seek to get out of this deal.

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A. It would eat up a considerable portion.

Q. Now, Professor --

A. I mean, for example, if I understand your financial statements correctly, it appears that transaction costs were 5 million of the 300 million.

Q. For the Liggett brand sale?

A. For the Liggett brand sale.

Q. But, Professor --

A. That's a big number.

Q. That's a big number. But, Professor, we're talking about -- the Liggett brand sale was a transaction between two corporations. You didn't have, in the Liggett brand sale, to go out to the capital market --

A. But it was --

Q. -- and attract investors, right?

A. But you had --

Q. You didn't have investment bankers?

A. But you had absolute state-of-the-art tax planning in there that I'm sure you paid Price Waterhouse, your, quote, "independent auditors," a small fortune to do.

Q. Professor, the sort of transaction you're talking about is not between two companies; it's between a company and whatever capital you can get from

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the vast capital market?
A. Right. So you can't do the kind of tax planning that was done on the brands transaction.
Q. Professor, if your testimony is accepted and judgments for punitive damages are entered against each of these five defendants in the order of magnitude that you've been talking about, all of the companies likely would be going to this capital market at or about the same time; is that right? I'm not asking when; but at some point --
A. Well, you know, again, I can't tell you. I mean, that -- at what point you decide to start pricing or deal -- or whether you're going to hold your breath until the process is over and then all panic at the last minute, living in denial, I mean, I can't tell you that.
But if you all hold your breath, wait until the absolute last minute and then suddenly realize you have to pay money and it's required that you pay it all at once, which doesn't seem realistic, yeah, that's right.
Q. Professor, if there's a verdict in this case, the capital market will know --
A. It's --
Q. -- the capital market will know that every

one of these five companies is -- at some point is going to be going to the capital market, right?
So even if Liggett goes today and Philip Morris goes a year and a half from now, the market is going to know that Philip Morris is going to be there eventually?
A. But to the extent liquidity is a concern in the capital market, if you spread it over time and don't all go at once, it's not -- there's -- the simple -- I mean, the simple reality of moving this kind of money all on one day is absolutely unprecedented.
So that effect is considerably larger than the effect of all of you raising capital tactically, properly planned, over whatever period you have from when you decide you might need it to when you actually have to pay it.
And more to the extent that you can then further pay it over time, again, it has less effect on the total liquidity on the market.
Q. So what you're saying is if these five companies came up with some sort of tactical plan, maybe they could work something out?
A. The assumption that they would be self-destructive and all wait and all try to pay a lump

sum, the fact that the Court will make them pay, all of them pay on the same day -- even though that's stupid for everybody involved -- it's --
MR. ROSS: Objection, Your Honor.
THE COURT: Well, yeah. I think we are really going into an area that --
MR. MARKS: I'm going to move off this, Your Honor.
THE COURT: Okay. I'll sustain the objection, if you're going to move on.

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BY MR. MARKS:

Q. Professor, of these five companies, right, going to the capital market, Liggett would be the least attractive of the five, for an institutional investor?

A. For an institutional investor, absolutely.

Q. Professor, I want to talk to you about a few other things that could adversely affect your confidence in Liggett's ability to pay?

Professor, the fact that over the last five years Liggett's market share has declined sharply -- in 1995 it was 2.5 percent; in 1999 it was 1.2 percent -- the fact that its unit volume has also declined sharply -- 1995, 10.5 billion cigarettes sold; 1999, 5.2 billion cigarettes sold -- and the fact that Liggett's business has moved sharply from premium brands to

discount brands, these are all factors that you would take into account in evaluating Liggett's ability to pay; isn't that correct?

A. Yeah, also, you know, your operating income is up like 40 percent.

Q. Professor, you say the operating income is up 40 percent. You're looking at the year-end 1999 numbers?

A. Comparing it to year-end -- does that have the brands -- no, that doesn't have the brands profit in it, no.

I'm looking at year-end '99 and year-end '98. I didn't want to take the brands transaction into account.

Q. I understand that.

Now, Professor, you also had access to first-quarter numbers for this year for Liggett?

A. Yes.

Q. Professor -- correct me if I'm wrong -- Liggett's operating income for the first three months of 2000 is $9 million; a year ago it was $20 million.

A. Notice that even though your gross went up by -- I don't know, 20 percent, say, your advertising -- your selling general and administrative, which includes, among other things, advertising, went

up.

So one thing is you may have had a big advertising campaign for Eve. I just don't know.

Q. You don't know, do you?

A. I do not.

Q. And if there was no big advertising campaign for Eve, then you would agree with me that Liggett's operating income for this three-month period in 2000 is down over 50 percent from a year ago?

A. I don't know enough about the seasonality of your business, and particularly when you do the big shipments to your big customers, to know whether the first three months are representative.

Q. But, Professor, is 20 million in 1999, first quarter; 9 million, first quarter, 2000, that's a fact, right? You have no reason to disagree with these statements?

A. I have no reason to disagree with those statements.

Q. Professor, the fact that there are tobacco companies in the United States today, companies such as

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Commonwealth, Star, Medallion, these companies that are very close in size, very close in volume to Liggett --

MR. ROSENBLATT: I'll object to counsel testifying.

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THE COURT: Yes. I'll sustain that at this point.

BY MR. MARKS:

Q. Professor, the fact that there are other companies in this country that are almost the same size as Liggett --

MR. ROSENBLATT: Same objection. That's just what I objected to.

THE COURT: There are other companies, okay.

BY MR. MARKS:

Q. Professor, are you aware there are other companies in the United States about the same size as Liggett?

A. In what business?

Q. In the cigarette business, that are not defendants in this case?

A. Oh, yes.

Q. You are aware of that?

A. Yes.

Q. Okay. Now, the fact that there are other companies in the cigarette business in the United States that are about the same size as Liggett, and that these companies are not defendants in this case --

A. I didn't say about the same size.

Q. That was the question.

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THE COURT: That was the issue.

A. You said do you know other cigarette companies.

THE COURT: Back up. Question No. 1: Do you know there are other companies selling cigarettes in the United States besides Liggett and these defendants? Answer?

THE WITNESS: Yes.

THE COURT: Now, next question.

BY MR. MARKS:

Q. Do you know there are other companies in the United States, not these defendants, that are about or close to the same size as Liggett?

A. Given that there's only about 1 percent market share left, and you've got -- wrong piece of paper. You've got 1.2 percent, so they can't be -- they would be a little bit smaller.

Q. Professor, are you familiar with the Maxwell Report?

A. I've heard of it.

Q. Do you know what it is?

A. I really don't.

Q. You're testifying as an expert in tobacco and you don't know what the Maxwell Report is?

A. That's right.

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MR. ROSENBLATT: Objection, Your Honor.

THE COURT: Sustained. Your people have to explain it.

MR. ROSENBLATT: Don't stick it up on the thing.

MR. MARKS: I can show it.

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MR. ROSENBLATT: My understanding is my objection was sustained.
THE COURT: You can't if he doesn't know what it is. Your expert can explain it.
BY MR. MARKS:
Q. Professor, what is your basis for saying the other companies in the United States only make up 1 percent of the market today?
A. The public market share numbers that I have available to me; but measured by cigarettes. There might be companies out there that are very profitable, but based on -- if you accept the shipped share and you add together the shipped share of everyone in this room, there's not much room to move in terms of shipped share.
Q. If you add up the shipped share for all of these companies, assume that's 100 percent, you're going to come up with 100 percent of everything?
A. Not shipped share -- I've been puzzled by --

when the industry talks about shipped share -- I like the USDA numbers. If the USDA numbers, which include imports -- people in this room, when they talk about market share, they talk about shipped share. I don't understand what that is, but I was trying to be in line.
Under the USDA numbers, which for last year were 435 billion, here is room for companies -- that includes imports. But there's room for companies as big or maybe even bigger than your company.
Q. If there was a company as big or even bigger than my company that didn't face lawsuits like this, that would be a factor to include in your evaluation of Liggett; isn't that right?
A. Well, depends -- faced lawsuits like this?
Q. Liggett faces hundreds of lawsuits, right?
A. Yes.
Q. You have read the financial statements?
A. Yes.
Q. If those companies had none --
A. Yes. That would be a factor.
Q. Professor, I now want to discuss with you the methodology you used yesterday morning to evaluate Liggett and the other companies, with the exception of Philip Morris.

A. Uh-huh.
Q. What you did essentially for the other four companies -- correct me if I'm wrong -- is you took Philip Morris' payment of $300 million through the three Liggett brands, which I guess in 1998 paid up .2 percent of the domestic market?
A. That's what --
Q. "That's what" what? That's what you were told?
A. That's my understanding, and that's represented in various documents.
Q. And you multiplied that out to get values for each of these companies?
A. Right.
Q. Now, you didn't use that method yesterday to valuate Philip Morris, did you? You used a different method for Philip Morris?

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A. I was asked my preferred method on direct, and I gave my preferred method on direct.
Q. The method that you used, that you told this jury --
A. Yeah.
Q. -- was the value of Philip Morris was not the method of extrapolation from the brand sale?
A. Correct.

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Q. You used a completely different method for Philip Morris?
A. Yes.
Q. One method for Philip Morris, a different method for the other four?
A. In response to questions, yes.
Q. In response to whose questions? In response to Mr. Rosenblatt's questions, correct?
A. Correct.
Q. Okay. Nobody else was telling you to use a different methodology for four companies than for one, right? This was in response to Mr. Rosenblatt's questions?
A. I understand there were procedural objections to using that method for other companies. I don't control what questions I'm asked.
Q. Okay. You also understood that for these four companies, the L&M, Lark, Chesterfield method produced the largest number, a larger number than the other method; whereas the -- whereas your -- I don't know how you even describe it, the international --
A. Well capitalized.
Q. -- synergy --
A. Yeah, whatever.
Q. -- method used for Philip Morris, that came

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out with the largest number for Philip Morris, right?
A. Yes.
Q. The bigger the better. That's what Mr. Rosenblatt told you?
A. Told me? No. That's an inference you can draw from his questions. He didn't tell me anything.
THE COURT: I think we better come sidebar. I have no idea what you're doing.
(Proceedings were had at sidebar)
BY MR. MARKS:
Q. Professor, you understand that Chesterfield, Lark, and L&M are premium brands?
A. Yes, I do.
Q. As opposed to discount brands?
A. Correct.
Q. And you understand that discount brands are lower priced brands, and logically have lower profit margins.
A. Depends on the advertising budget; but in general, yes.
Q. And, Professor, you would not accord the same value to a percentage of the marketplace that was in the premium -- in the discount brand segment as you would to the premium brand?
A. That's correct.

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Q. You wouldn't say that GPC at 5 percent is as valuable as Winston at 5 percent?

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A. Absolutely.
Q. Professor, with respect to Liggett's product mix, you saw in Liggett's financial statements, the 1999, 88 percent of Liggett's product mix was in the discount segment?
A. You've got Eve, and that's about it.
Q. Only about 12 percent of Liggett's sales were in the premium segment?
A. That's correct. As I mentioned earlier, it's that shift that makes me so uncomfortable -- made me relatively uncomfortable with you, as compared to others, because your business changed so radically as a result of that transaction.
Q. So for 88 percent of Liggett's business, the amount that's in the discount segment --
A. Right.
Q. -- it would be unreasonable, would it not, to apply this premium brand transaction to valuate that part of Liggett's business; is that right?
A. It would -- a more refined analysis would require adjustments.
Q. Require adjustments, which you did not do?
A. Which I did not do, yes.

Q. Professor, do you know what the term "contract manufacturing" is?
A. Yes.
Q. What --
A. Oh --
Q. What does it mean?
A. It means where a manufacturer simply builds cigarettes for somebody else who maybe brands them themselves and sells them.
So the only profit of a contract manufacturer is the manufacturing profit.
There is no brand profit, there's no wholesale markup. It's the most secure, in a sense that when you've got a contract, you've got a contract. But it's also the least profitable, unless you do a really stupid advertising campaign way of making cigarettes.
Q. So the contract manufacturing -- "private label" is another way to refer to it?
A. Right.
Q. In the cigarette market, that is something that's not terribly profitable?
A. Compared to what?
Q. Compared to premiums?
A. Compared to Marlboro, you bet.

Q. So, again, it would be unfair to simply apply the Chesterfield, Lark and L&M theory of valuation to private label contract manufacturing?
A. Yes.
Q. Is that right?
Professor, do you know what black and white cigarettes are?
A. If I do, they are sort of a hybrid between cigarettes and cigars. I don't think that's what you're referring to.
Q. Professor, have you ever walked into a store, saw a product --
A. Oh, the generic, that product. There was a

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brand called Black and White.
Q. I'm not even talking about a brand.
A. Yeah.
Q. You walk into a store, see a package, a lot of consumer products --
A. It's generic.
Q. It just says the product name; it says "cigarettes" on it.
A. Right. I think of that as generic.
Q. Not a lot of brand value there?
A. No.
Q. Certainly, again, unfair to simply apply the

Chesterfield, Lark, L&M theory to black and white cigarettes?
A. Yes.
Q. Professor, if it were the case that 60 percent of Liggett's volume, their sales, is in the private label and in the black and white business, doesn't that give you a little bit of pause --
A. Yes.
Q. -- about your valuation of Liggett?
A. About the -- using the brands transaction as a means of valuing Liggett's intangibles, which is, again, the reason I prefer the other method.
Q. Were you aware, before you came here today, that 60 percent of Liggett's business was in private label and black and white?
A. I knew it was almost entirely -- my understanding was except for Eve. I would have thought the numbers were even higher.
Q. Professor, when I say private label and black and white, I'm talking about 60 percent of Liggett's business; they don't even own brands.
A. I understand -- I thought -- I knew you did a great deal of contract manufacturing, and I thought that was the lion's share of your operation.
Q. Professor, on an intangible basis, a

brand-value basis, Liggett is on a completely different planet than these four other companies?
A. Absolutely, after the brands transaction, you were on a completely different planet.
Q. Professor, a couple more things about the brands transaction.
You spoke yesterday at some length with respect to your valuation of Philip Morris about synergies and values created by owning a brand across borders; isn't that right?
A. Yes.
Q. If I understood you correctly -- correct me if I'm wrong -- it's your opinion that the value of the Marlboro trademark worldwide in sum is far greater than its value in parts; and if someone --
A. Yes.
Q. -- broke it up between domestic and international --
A. Yes, given the way it's currently used.
There are a good many trademarks today as Benson and Hedges that are separately owned, and I don't know what side agreements they have about promotion, so the -- but it is clear that one of the reasons for the power and value of the Marlboro name is

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the joint international marketing and promotion of the

name.

Q. Now -- your words -- separating Marlboro into two pieces to make them domestic and international and selling them separately -- your words -- you throw away a lot of value?

A. The current Marlboro as currently operated.

Q. A lot of value?

A. Yes.

Q. Now, the three brands, L&M, Lark and Chesterfield --

A. Yes.

Q. -- you understand, because you've seen from Philip Morris' annual reports, that 20 years ago Philip Morris purchased from Liggett the international rights to these three brands?

A. Yes, I knew that.

Q. Since you've seen the annual reports, you know that today these three brands, L&M, Lark and Chesterfield, are very successful for Philip Morris overseas; is that right?

A. I know L&M is very successful. I don't know about the others.

Q. Behind -- L&M is Philip Morris' second top-selling brand overseas, after Marlboro?

A. That I didn't know.

Q. Did you know that Lark is the top-selling cigarette in Japan?

A. It came up in here two days ago.

Q. So you heard it here?

A. I heard it here.

Q. So, Professor, under your theories, under your synergy theories, the value of the domestic rights of ownership to the L&M, Lark, and Chesterfield brands is far greater in the hands of Philip Morris than in the hands of Liggett; because Philip Morris, unlike Liggett, is able to access these synergies, these international synergies created by Philip Morris, by already owning the international rights. Isn't that correct?

A. They were the best positioned people to realize on the value.

Q. And best by far?

A. Right.

Q. Therefore, Professor -- so you agree with me that in Philip Morris' hands -- the value of the domestic rights to Liggett's Lark, Chesterfield and L&M is greater in Philip Morris' hands, because of the international brands also, than it is in Liggett's hands?

A. But there is a flip side to the story, which

is -- assume you've got a special car, and there's one buyer who really, really wants it, and you know he really, really wants it.

Even though he might be the only buyer, you know that he really, really wants it, so you're going to do your best to capture some of that in the negotiations.

Q. That's right. And Philip Morris is going to pay Liggett a lot more than Lorillard is going to pay

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Liggett; a lot more than RJR is going to pay Liggett; a lot more than B&W is going to pay Liggett, according to your own theories?

A. But the flip side is that the buyer, knowing that probably no one else is at that point in the market -- and, remember, the market at the time -- never mind. I'm confused about it. Forget it.

Knowing that -- apparently they were in the market and could say: Well, we don't want them.

So that, provided that there wasn't a gun at anybody's head, even though you've got a motivated buyer, you've also got a smart, sophisticated seller, and therefore that's no reason to believe that at least some of the fact that Philip Morris could exploit these brands wasn't captured.

Q. Professor, very simply, under your

theories --

A. Yes.

Q. -- about international synergies and whatnot --

A. Right.

Q. -- the domestic rights to the L&M, Lark and Chesterfield brands are more valuable in Philip Morris' hands today than they would be in any of these other companies? Very simple.

A. There would be more value to Philip Morris if they bought them than there would be value to anybody else.

Q. Professor, yesterday, in valuing Philip Morris, you included, did you not, the international value for L&M, Lark, and Chesterfield?

A. I did.

Q. Now, because you did that, Professor, utilizing the different theories that you used here, utilizing this international synergy theory for Philip Morris on the one hand --

A. Uh-huh.

Q. -- and then trying to isolate the value -- the domestic value to Philip Morris of L&M, Lark, and Chesterfield on the other hand, and using that to value the other companies, that's perfectly inconsistent,

isn't it?

A. I don't see how it's inconsistent.

Q. Professor, you just told us that -- Professor, you just told us that --

A. I believe that a capital --

THE COURT: Wait a minute. I don't want to get into an argument.

His answer is his answer, whether you agree with it or not. Now, he hasn't finished his answer. Let him complete what he's going to say.

Go ahead.

A. (Continuing) As I said yesterday, as I've written about and talked about, I think businesses need to be valued at whole; that the best proxy for the sale of a business is valuing the business as a whole.

However, sometimes you're not comfortable with that, so you try to break a company down into pieces in order to reverse engineer the value of a business as a whole.

One way to do that here is with the brands

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transaction method. It -- because it doesn't look at a business as a whole, because it breaks it down into artificial pieces, is why I'm less comfortable with it. But it is certainly one way of trying to capture the value.

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I -- as I've said before, because I believe businesses should be valued as a whole, period, much prefer in your case if the -- I just think it's much more intellectually elegant whatever the -- basically the .9 billion number than the twice that size 1.8 billion number, precisely because I believe in businesses as a whole.

Q. Professor, you would agree with me, then, that using the Liggett -- the L&M, Lark and Chesterfield value, the $300 million to value these four other companies is not intellectually elegant; is that right?

Because you're not using your best theory; you're not including in that what Philip Morris really values, what you think Philip Morris really values those --

A. I do disagree. The reason -- I had a thought here.

I don't think we have evidence that Philip Morris got ripped off by Liggett.

My understanding -- I was given a copy of the transcript of Mr. LeBow's deposition. He says he wasn't ripped off; that he thought it was a fair value; that he would have sold it to anybody.

Q. Professor, you agree that they weren't ripped

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off, isn't that right, because Philip Morris was able to access these international synergies?

A. Well, can I -- let me -- if I may, this was provided to me by Mrs. Rosenblatt.

MR. MARKS: Your Honor, I really don't think it's proper for him to be reading from a deposition transcript right now.

THE COURT: Well, you know --

MR. MARKS: I'll move on.

THE COURT: The problem is, you opened the can of worms. I'm not sure where we're going with it.

MR. MARKS: I'm going to move on.

BY MR. MARKS:

Q. One last issue.

In performing your analysis for Liggett and reviewing the company's financial reports, you recognized, did you not, that Liggett has a sister, affiliated tobacco company in Russia called Liggett Ducat?

A. I did.

Q. But you did not include that Russian company in your valuation of Liggett, as you recognize Liggett Ducat is a separate entity; no continuity of brands with Liggett?

A. Right.

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Q. And you respected and treated that as a separate entity?

A. Right. My understanding from your financial statements is that under Russian law, they really can't operate together, and therefore, I viewed them as

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completely separate.
Q. So your valuation of Liggett today is based solely on the domestic tobacco company?
A. Yes. I did not include -- unless I goofed and there's some Liggett Ducat numbers that have snuck into your financial statement in ways that I have missed, I did not want to include Liggett Ducat.
Q. Your intention was only to value Liggett's domestic background?
A. Yes. I don't see any basis for looking at Liggett Ducat.
MR. MARKS: That's all the questions I have.
THE COURT: All right. Anybody else? No. All right. Redirect?
MR. ROSENBLATT: I'll be a while, Judge. Would it be a good time to take a short break now?
THE COURT: We'll take a short break.
THE BAILIFF: Everyone please rise.
(The jurors exited the courtroom.)
(A brief recess was taken.)

(The jurors entered the courtroom.)
THE COURT: All right. Have a seat. We're on redirect.
MR. ROSENBLATT: Good morning, ladies and gentlemen.
THE JURY PANEL: Good morning.

REDIRECT EXAMINATION

BY MR. ROSENBLATT:
Q. Professor Mundstock, obviously you've been asked a lot of questions, and I'm jumping around from subject to subject.
You were asked some questions along the line of, you know, you've never been an investment banker, you've never worked in a Wall Street investment banking firm.
In order for someone to give tax advice at the highest level of corporate transactions, does the tax advisor have to understand the nature of the most complex kinds of corporate transactions?
A. Yeah. In fact, usually the tax advisor is the person who usually structures the transactions.
Q. And does the tax specialist --
A. Can I --
Q. Sure.
A. The corporate tax rate, state and local, is

about 40 percent.
So as you would expect, when you have about 40 percent of the money on the table potentially going to the government, tax returns dominate, and therefore, in terms of structuring and understanding the deal, because the tax is dependent on the structure, and you can't do the tax unless you understand the structure, and the structure depends on the taxes in a properly planned transaction; and, therefore, at least on a quality team doing a corporate transaction, the people who push the paper and the people who do the structuring, the tax lawyers should be working in concert.
Q. Is it fair to say that at the highest levels of corporate transactions involving big, big money, sometimes in the billions of dollars, that what may

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cause a deal to go through or cause a deal to bust apart is the perception of the tax consequences?

A. Well, I wouldn't say perception, but taxes can make or break a deal.

Q. Now, why, for example -- you know, I looked at your book. Why do law students, people who are going to become general lawyers, need to know about Nike and General Electric and Microsoft and Coca-Cola?

A. I would say two reasons. Generally, that --

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as we discussed now two days ago, accounting is the language of business. It's the way companies talk, about the numbers that appear on their books and records based on their historical transactions.

So in almost any business context, a lawyer has to be able to talk the talk. And, therefore, I believe that -- in fact, the number -- recently, the American Bar Association did a poll, and concluded that the number-one thing that lawyers five years out of law school wish they had studied more in law school was finance and accounting.

So the first thing is to meet that goal. Young students come to law school thinking they're just going to learn law. They can leave everything to everybody else; all they need to know is law.

And as I teach my students, law as easy facts are hard, and that you've got to understand the facts. And in business transactions, the talk is the financial accounting.

So that's generally why they need to understand financial statements.

Q. Okay. You've answered my question.

Now, you were asked a series of questions in litigation risks and taking that into account from the standpoint of evaluating companies.

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Now, I want you to assume that the tobacco industry has never paid a dime to any living or dead smoker in the history of tobacco litigation. Would you agree that that is the type of track record that would be taken into consideration in a Wall Street deal relating to a punitive damage award, if the companies went out to borrow money?

A. Yes.

Q. Now, Mr. Lerman asked you a series of questions from your curriculum vitae, you know, where you worked since you received your law degree; talked about the United States Treasury; talked about your employment at Jones and Day.

Actually, you worked for a period of time for the law firm that Mr. Webb and Mr. Lerman practice with, Winston and Strawn, correct?

A. Briefly.

Q. Tell us the period of time you worked for them.

A. I worked for them the Summer of 1987, for like 10 or 11 weeks, and then -- in Chicago, and intermittently in the Fall of '88, in DC.

Q. Okay. Now, big firms have divisions. You were not in the litigation division, such as they are, correct?

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A. No. I was definitely in the tax group. By

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that time they had formal divisions. When I was at Jones Day they weren't so formal.

Q. Now, I wanted to clarify some questions and answers that you gave on cross examination.

When you talk about the concept of valuing a company and ability to pay, wouldn't you agree that the ability to pay may exceed the value of a company, depending upon the unique nature of its future cash flow?

MR. JOHNSON: Objection, leading.

THE COURT: Well, "wouldn't you agree" was leading.

BY MR. ROSENBLATT:

Q. Do you agree?

THE COURT: "Do you agree" is not.

MR. ROSENBLATT: With that amendment.

A. The longer they have to pay, the longer the time period they have to pay, the more money is available to pay.

You know, for these defendants, given their ability to generate cash, they're able to pay over time periods, you know --

MR. LERMAN: Your Honor, I object to this.

THE COURT: Let me see if we can get back to

the question. The ability to pay may exceed the value of a company, depending upon the unique nature of its future cash flow. That's the question.

MR. ROSENBLATT: Correct.

THE COURT: Do you understand the question?

THE WITNESS: Yes.

MR. ROSENBLATT: And you were in the middle of answering.

THE COURT: Overrule the objection.

Q. Had you finished your answer? Finish it.

A. The tobacco companies are known for their abilities to generate cash flow. They advertise that in their financial information to try to protect the price of their stock and keep their shareholders happy. And their ability to generate cash over time is truly remarkable.

The numbers that we've been talking about the last two days are in -- all at once in a properly structured transaction.

Q. You were also asked a series of questions about whether you felt more comfortable with one method of valuation than another, and you responded to those questions.

Do you agree based upon reasonable economic probability that in this case, even though it's not

your preferred method, that in this case, preparing a valuation of approximately $157 billion based upon the price, Philip Morris paid for the three Liggett brands is fair, reasonable and valid?

MR. JOHNSON: Objection. Leading.

BY MR. ROSENBLATT:

Q. Do you agree?

MR. LERMAN: Your Honor, even the phraseology "do you agree" doesn't solve the problem.

THE COURT: It's a little awkward when you come to leading questions. He's definitely asking a question. Basically the import of the question is:

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Was this a fair payment?
BY MR. ROSENBLATT:
Q. Even though it's not his preferred, his number-one choice evaluation, I'm asking you whether or not you nonetheless consider it as a method of valuation to be fair, reasonable and valid? Do you?
A. Yes, and overwhelmingly more so than book value, except in the case of RJR.
Q. Now, you knew what the substance of Mr. Cherner's testimony was before this jury, and the methodology that he used, correct?
MR. LERMAN: Your Honor, I object. Is counsel testifying? There's nothing in the record that

says that.
THE COURT: We're going to get into a lot of trouble if we start parsing this out. Ask it in a question form rather than in a statement form.
BY MR. ROSENBLATT:
Q. Did I make you aware of or did Mr. Cherner make you aware of what his method of analysis was going to be in terms of valuing the tobacco companies?
MR. LERMAN: Your Honor, I object to -- instead of a speaking objection --
THE COURT: No. I don't need a sidebar. Overrule the objection.
A. Well, actually, your wife told me about it.
BY MR. ROSENBLATT:
Q. Okay. And did either my wife or I or Mr. Cherner ask you the same question I just asked you a moment ago, as to whether you considered this to be a reasonable and valid method of valuation, even though it was not your personal first choice?
THE COURT: Hold on.
MR. REILLY: Object.
THE COURT: I'll sustain that.
BY MR. ROSENBLATT:
Q. A lot of terms were thrown around on cross examination. Is book value the same thing as net

worth?
A. Not to me.
Q. What is the amount of money that these tobacco company defendants could afford to pay on a punitive damage judgment without going out of business, if they had the right to pay out the money over an extended period of time?
MR. LERMAN: Objection --
MR. WEBB: Objection. Mistrial. Can we have a sidebar, Your Honor?
MR. ROSENBLATT: Mistrial?
MR. WEBB: Yes.
THE COURT: All right. Let's have a sidebar.
(Proceedings were had at sidebar)
THE COURT: I'll tell you what, Counsel. Let's take a short recess.
THE BAILIFF: Everyone please rise. The court is now in recess.
(A brief recess was taken.)
THE COURT: If you would move on to a different subject at this point, and we'll take up that issue later.
(The jurors entered the courtroom.)

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BY MR. ROSENBLATT:
Q. Professor, during the course of cross

examination, you were asked a lot of questions along the line of "in the real world," how things happen in the real world, high finance, Wall Street, that kind of thing.

Let me ask you a similar kind of question.

In the real world, how does a company such as Philip Morris say on the one hand that it's worth $6.4 billion, that that's its book value, and then yet voluntarily agree in 1997 to pay the majority of $368 billion?

A. Well, obviously, the $368 billion figure was to be paid out, if I understand the '97 Tobacco Resolution, over 25 years; and that the fact that they -- well, two -- two reasons: One, obviously, the 6.4 billion isn't their real value; and two, that the -- it's easier to pay out money over time than it is to pay it all at once. As we've discussed over the past two days, to come up with a great big lump of change at once requires some complicated transaction to access the securities markets.

These companies are cash cows, and therefore, over time they can throw off considerable cash flow over a period of -- I mean, the tobacco companies pride themselves on their cash flow and their ability to generate cash.

Q. And, of course, the cash comes from smokers who are buying cigarettes?

A. Right.

Q. Counsel asked you some questions about a document that you brought with you to your deposition.

A. Well --

Q. "Talking points"?

A. Yes.

Q. Remember that?

A. Sure.

Q. And as it stated --

MR. LERMAN: Your Honor, I object.

THE COURT: No -- let me talk to you about that.

(Proceedings were had at sidebar)

BY MR. ROSENBLATT:

Q. When Mr. Lerman was questioning you and was going over the entities under the umbrella of Philip Morris Companies, Inc. and discussed with you Philip Morris, Incorporated, Philip Morris International, Kraft Foods, Miller Brewing Company, among the entities was a company called the Philip Morris Capital Corporation. And Mr. Lerman, in a question, said to you: The Philip Morris Capital Corporation finances business deals.

What does that mean to you, they finance business -- in terms of the Philip Morris context?

A. Hold on a second. Let's quote them. I assume the leasing, mostly.

Financial services: Philip Morris Capital Corporation does -- says it's -- they do -- it's like a small finance house. They do leasing and structured finance portfolio, probably equipment loans. Since

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they weren't an issue, in this case I didn't study them.

They usually are just the finance arm of Philip Morris International; that they arrange financings for smaller business; i.e., they find ways of getting money to smaller businesses than Philip Morris.

Q. Is there anything that would prevent Philip Morris Companies from giving Philip Morris, Inc. money?

MR. LERMAN: Objection. Objection, Your Honor. Your Honor, I need to be heard on this.

THE COURT: Do you want to talk about that? We'll talk about that.

(Proceedings were had at sidebar)

BY MR. ROSENBLATT:

Q. You had mentioned the Philip Morris Companies 1999 annual report.

A. Uh-huh.

Q. I want to read to you a sentence from Geoffrey Bible, the chairman of the board and chief executive officer, "To our shareholders," where he says on Page 2: "In the long-term, we believe our valuation will ultimately be driven by our rock-solid business fundamentals and exceptional cash flow."

MR. WEBB: Your Honor, I object on the same grounds -- we're talking about the parent company here, Your Honor.

THE COURT: Yes. Just depends where it goes next and how that's utilized.

BY MR. ROSENBLATT:

Q. My question is: When you were talking about the tobacco companies being cash cows, is that consistent with Mr. Bible's reference to the exceptional cash flow?

A. Yeah, and there have been similar announcements, particularly from RJR over the years.

Q. When you worked for Jones Day, were you involved in commercial transactions?

A. Well, to a corporate lawyer, a commercial transaction is like a loan transaction. Not a corporate transaction. Is that what you're asking? I didn't do any lending documents.

Q. Were you -- I guess what I'm asking is, were you involved in terms of the sale of businesses?

A. Oh, yes, all the time.

Q. Where businesses had to be evaluated?

A. Yes.

Q. And valued?

A. Yes. Primarily because the value depends on the taxation, and the taxation depends on how you value the pieces of the business. It goes hand-in-hand. So you can't separate the two. I mean, you ---

Q. Now, your undergraduate degree was in mathematics, and you graduated Phi Beta Kappa?

A. Yes.

Q. You're a numbers guy?

A. Yes.

Q. To put it crudely.

A. Yes. I'm a numbers guy, yes.

Q. A detail person?

A. Yes.

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Q. Looking at balance sheets and financial statements and looking behind the numbers is what you do?
A. Yes.
Q. Now, we've heard the term thrown around in terms of "litigation risk."

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I want you to assume that there is not any other class action, other than this one, in the history of tobacco litigation, that has ever gone to trial or has ever been certified to go to trial. Would that be a significant factor in terms of an investment house evaluating whether to loan a very large sum of money to a tobacco company?
A. Yes.
Q. Now, when you were with the United States Treasury Department and you were involved with the Tax Reform Act during the Reagan administration -- and, by the way, did the tax reform proposal during -- I guess it was 1986?
A. It came out in '84; it was ultimately passed in '86.
Q. So it became law?
A. In '86.
Q. And it covered all 50 states?
A. Oh, yes.
Q. Did you have to understand the economy in order to do the work that you were assigned to do?
A. Yeah. And, specifically, I did the business side. Vic Thuronyi did the individual side.
So my thing was the business side, particularly depreciation, corporate dividends,

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corporate tax shelters, worrying about how those were affecting the tax system, and the economy was primarily what I worked on.
Q. We heard this phrase -- don't whisper to her.
THE COURT REPORTER: It was a spelling.
Q. We heard this phrase "market analysts."
A. Right.
Q. Are there people on Wall Street who basically do nothing other than study the tobacco stocks, see if they're going up and going down, and predict to investors whether they should buy or whether they should sell?
A. That's what a market analyst does.
Q. That's what a market analyst does.
I want to hand you, just to look at a few very, very recent reports from tobacco analysts -- and don't read anything out loud -- and I'm going to simply ask you a question when you get done reviewing these --
MR. LERMAN: Your Honor --
Q. -- as to what the tobacco analysts say as to whether buying a tobacco stock is a good thing or not.
MR. ROSS: Objection. Beyond the scope and hearsay.
THE COURT: Wait. I make the decision. You tell me how much taxes to pay.

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THE WITNESS: As much as you can.
(Proceedings were had at sidebar)
BY MR. ROSENBLATT:
Q. This concept of market capitalization, do I

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understand correctly that that means that someone simply does the math, how many outstanding shares of stock are there, what is it selling for on a given day, and you multiply the two?

A. Yeah. It's usually close of business. So it's the last sale at the end of the day times the number of shares.

Q. So although market --

A. It's the number of outstanding shares; it's not options and everything -- it's just the shares that are -- it's just the number of shares currently traded times the last trade on a business day.

Q. So market capitalization requires no analysis at all, does it? It's just a matter of doing the math, the multiplication?

A. Right.

Q. You had said something in response to a question on cross examination about a tender offer making the stock price go through the roof.

A. Yes.

Q. What did you mean by that?

A. Well, the way it usually happens is one company wants to acquire another company.

There are two ways to do that: Either call up the board of directors of the company and say, "Will you sell?" or you can just do what is called a hostile tender offer, where you just go after them and go to the market and say, "I want to buy all the stock. Will you sell?" to the shareholders.

In any event, whether it's a hostile or a friendly tender offer, and there are degrees in between, there usually is a vote by the board, but the ultimate approval is the shareholders. The shareholders own the company, and they've got to go along with the deal.

The securities laws protect shareholders in these situations. There are -- there is specific legislation designed to protect them, that basically requires someone making a tender offer to announce that they're going to, so that the market can get this information.

The securities laws generally try to protect investors by giving them the information that a reasonable person needs to know about whether to buy or sell stock, and the government protects you so you have all the information.

And what normally happens in a tender offer is that the minute the market hears that somebody wants to buy all the stock, they -- the stock and the price starts going up.

People buy the stock just hoping that there will be a runup. These people are referred to as arbitragers. And frequently these people come in and buy the stock from the old shareholders speculating it's going to go up even more as a result of the feeding frenzy that occurs while a tender offer is taking place.

And normally companies trade at, you know, big -- considerably more. Like twice value is not unusual because of this.

Now, why does this make any sense

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economically? Well, one, when you're a little shareholder and you go to a shareholder meeting and tell somebody -- the management what you want to do, they may talk to you; they're certainly not going to listen to you.

If you own 100 percent of the company, you've got it; it's yours. So that -- and when someone announces that they want 100 percent of a company, people assume that they want it for a reason, and they're willing to pay extra for the privilege of

control. Mr. Lerman actually brought this up yesterday. This is the control premium.

The other reason that most economists feel there is a premium -- in some of these transactions -- in some of these transactions is that buyers usually do these in what are in effect leverage buyouts; that the buyer is buying stock, and in fact the new company has much more debt and much less stock than the selling company.

This creates interest deductions that make the income -- after-tax income of the buying company greater than the after-tax income of the selling company; and therefore, you have this sort of tax mystery that if you can do a leveraged buyout, the company is worth a lot more because of the tax shield, the extra tax benefits created by the new deductions.

Q. Okay. I'm going to stop you there.

You were asked some questions on cross examination about this concept of Florida trying to securitize its tobacco payments.

To your knowledge, has the state of Florida done that?

A. No.

Q. Under the Master Settlement Agreement, do the states and the legislatures of the states have an

incentive to take action to protect their payments?

A. As any holder of a debt obligation would.

Q. So in a sense, is it fair to say that the state of Florida and all the other states -- ironic as it may appear to be --

MR. JOHNSON: Objection.

MR. LERMAN: Your Honor --

MR. ROSENBLATT: I'm in the middle of a question.

THE COURT: I'm trying to figure out where he's going. Let me see what the question is.

And your objection is to the words "ironic as it may be"; is that your problem?

MR. LERMAN: I have a problem beyond that, if I may be heard.

THE COURT: I haven't gotten to the end of the question.

MR. LERMAN: I think I can tell you.

THE COURT: You may be clairvoyant. Let's hear the end of the question first.

BY MR. ROSENBLATT:

Q. The end of the question is: Is it fair to say that the states, Florida included, by virtue of the MSA, have a vested interest in the economic well-being of the tobacco industry?

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MR. LERMAN: Your Honor, I object and --
THE COURT: That's --
MR. LERMAN: This is beyond the scope. And what is the relevance?
MR. JOHNSON: And it's leading.
THE COURT: No, it's not leading; and it's within the scope because it deals with what you talked about, the securitization of their payments.
Overruled.
A. Very much so.
BY MR. ROSENBLATT:
Q. You were having this exchange with Mr. Smith, when he was talking about what horrible shape Brown & Williamson was in. And then I believe you said: Well, sales are up 20 percent. Is that what the records reflect?
A. Yes.
Q. So how is it -- he apparently established to your satisfaction the last couple years, market share, Brown & Williamson has been going down. So how are sales up?
A. Price increases.
Q. And then remember he said to you: But that's just dollars.
A. Yeah.

Q. And remember when they put up on the screen your correspondence with Brian Reshevsky of Credit Suisse and First Boston -- I'm not going into the substance of that, but you recall that?
A. Yes.
Q. That was a former student of yours?
A. Yes.
Q. They remembered that because you brought it to your deposition with you?
A. Yes. And he was a former student in corporate tax, the only course he took from me. So --
Q. Now, at one point you were asked the question and -- or you said you did not pay a lot of attention to audited financial statements, and you said: For reasons you know. What were the reasons?
MR. SMITH: Objection, Your Honor.
THE COURT: Overruled.
A. What he specifically asked me was audited financial statements of the subsidiaries rather than of the group. And the reason was that I had planned on valuing --
MR. SMITH: Your Honor, you see we're getting into the area the Court --
THE COURT: Well --
MR. SMITH: See where we're going?

THE COURT: Let me talk to you about that. See if we know what we're talking about.
(Proceedings were had at sidebar)
THE COURT: Okay. Before we go any further, let's go ahead and take our lunch break. We'll try and iron out some of this stuff during the break.
Get back at 1:30, folks.
THE BAILIFF: Everyone please rise for the jury.
(The jurors exited the courtroom.)
THE COURT: Have a seat, folks.

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VOIR DIRE EXAMINATION

BY THE COURT:

Q. The question was broached as to what you meant when you said: And you know why I didn't do something.

Of course, without knowing what you're going to say, we became interested in what you would say, but we don't know that until we hear you say it. We had to hear you say it outside the presence of the jury. That's why we're where we're at.

A. I was going to say I didn't look at the subsidiaries' financial statements because I was relying on the parents' financial statements. Not that I ignored them, but that was not relevant for the

calculation I was doing.

Q. That's where you're at.

A. That's my answer.

THE COURT: We'll work with that when we get back.

MR. REILLY: Your Honor, I have one of the deposition transcripts.

THE COURT: Yes, please. I'll take it. Thank you. Homework.

MR. REILLY: The color-coding is indicated on the front. Your Honor, we have color-coded the designations, the objections and counterdesignations. They are all color-coded.

THE COURT: The usual color-coding. This is for everybody?

MR. REILLY: Everybody.

MR. REID: So you have our objections?

MR. REILLY: Yes.

MR. SMITH: Your Honor, I've got -- would you like ours after lunch?

THE COURT: I thought he said everybody's.

MR. REILLY: Everybody but Bennett LeBow's.

MS. LUTHER: Judge, I have Mr. LeBow's. Unfortunately, I don't have a copy of our objections, but it is color-coded there.

THE COURT: Okay. Wonderful dealing with you folks.

MS. LUTHER: Judge, what I can give you is an unsigned copy, if you want to have that to help follow along, what I filed.

THE COURT: That's fine.

MS. LUTHER: That's exactly what I filed. It's just not signed. (Handing)

THE COURT: Okay. The same rules apply.

THE WITNESS: Certainly.

(A luncheon recess was taken at 12:15 p.m.)

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